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FOR DEPUTY SECRETARY LEW FROM AMBASSADOR CUNNINGHAM

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SUBJECT: SCENE SETTER FOR DEPUTY SECRETARY LEW'S VISIT TO ISRAEL

Classified By: AMBASSADOR JAMES CUNNINGHAM, reason 1.4 (b) and (d)

1.(C) Summary: I am pleased to welcome you to Israel on your first official visit as Deputy Secretary of State. You will see that despite some difficulties we have a strong and dynamic bilateral relationship. In addition to looking into the effect of USG resources spent in the region, I am pleased that you will meet with U.S. Mission members, the stewards of those resources. Your visit will also encourage the Israelis you meet to ponder their future within a context of peace and security, capitalizing on a very valuable asset -- their culture of innovation. The current atmosphere of political and military calm is clouded by uncertainty in an international environment that feels markedly more hostile to Israelis within the last year. While the discussion has become more reasoned, Israelis in and out of government seek constant reassurance about the commitment of the Obama administration. With engagement with the Palestinians stalled, regional relationships have suffered. Economic growth returned relatively early in Israel, and the primary lingering effect of the global financial crisis, unemployment, continues to subside. Growing the economy and increasing the participation of all segments of Israeli society are priorities for the current government, and they are striving to remain fiscally conservative while pursuing these goals. End Summary.

EMBASSY TEL AVIV MANAGEMENT

12. (U) Embassy Tel Aviv manages a 50 million USD portfolio of allotments for its 27 ICASS subscribers. We employ 583 locally engaged staff and 185 Americans across the various agencies. In 2009, Tel Aviv supported 59 VIP visits; including two SecState, 34 CODELs, eight General Selva, nine Senator Mitchell, six FPOTUS and 8700 other official TDY visitors. Space is one of the major management issues for Embassy Tel Aviv. Since 2005, post has grown 35 percent in the number of American positions alone, with 12 new NSDD-38 requests already made in 2010.

POLITICAL LANDSCAPE

13. (C) Overall, Netanyahu's government is solid. He has carved out a position solidly within the Israeli consensus, and he is not under any serious political pressure to change course. The opposition, led by former Foreign Minister Tzipi Livni, has had a difficult time finding traction for its argument that it generally agrees with Netanyahu's policy of a demilitarized Palestinian state next to Israel but claims his commitment to peace is weak and argues that lack of international confidence in his approach is leading Israel to disaster. Israelis remain concerned about what they

see as increasing attacks on their legitimacy from the Goldstone Report, potential criminal prosecutions in Europe under universal jurisdiction, and increased calls for boycotts.

¶4. (C) Netanyahu is serious in his calls for a resumption of negotiations, and he is aware that the lack of progress in the peace process is fueling much of the international hostility towards Israel, as well as putting some strain on the relationship with the United States. The limited freeze on settlement construction, while short of both the Palestinian and USG expectations, was a difficult decision that carries a real political and financial cost. Israelis believe that this limited freeze, combined with the actions the GoI has taken to improve conditions in the West Bank, should be sufficient encouragement to the Palestinians to restart negotiations. The GoI is not anxious to offer any more gestures, and has doubts that any future gestures will yield a different response from the Palestinians.

¶5. (C) The Goldstone report is back in the headlines with the upcoming UN Secretary General report on the subject and the recent Israel submission of an update on its own investigations regarding incidents during the war. Israeli leaders have developed a virtually obsessive reaction to the report, which they see as an assault on both the State of Israel and its democratic institutions, and an attempt to deny their right to self-defense against terrorism. Assistant Secretary Michael Posner recently visited Israel and engaged with them on this issue in-depth. The Palestinian Authority's (PA) handling of the Goldstone report has further complicated Israel's relations with the PA and

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poses a threat to both the potential for negotiations and the efforts to improve the situation in the West Bank. In the meantime, Israelis express satisfaction with both Fayyad's efforts to reform the PA and with the much improved performance of PA Security Forces, although they believe the PA's assessments of its abilities on both fronts are overly optimistic. In Gaza, Israel policy is caught on the horns of a dilemma over Gilad Shalit and Hamas, continued control within the Strip.

¶6. (C) With regards to Iran, the GoI has accepted our policy of engagement, but Israel, particularly PM Netanyahu and DM Barak, continues to regard a nuclear Iran as an existential threat and a catastrophe for regional stability. The GoI has pushed for immediately enacting tougher sanctions and insists on keeping a military option available. Iran was the main point of discussion during last month's visit of NSA Jones. Israeli experts within and outside government argue that how the Iranian nuclear issue is resolved over the next two years will determine the perception of U.S. power for years to come.

¶7. (C) Deteriorating relations with Turkey are also a concern, and many Israelis believe that Turkey will continue to move inexorably away from Israel and the West and closer to Syria and Iran due to internal politics and a new regional strategy. On Lebanon, most GoI officials believe another war with Hizballah is just a matter of time, but they are in no rush to provoke anything and believe Hizballah, at least for now, also has no interest in a fight. However, they repeat both publicly and privately their belief that all of Lebanon will be held accountable for Hizballah actions now that Hizballah is a partner in the government.

ECONOMIC LANDSCAPE

¶8. (SBU) The Israeli economy weathered the global downturn relatively well, registering GDP growth of 0.5 percent in 2009. GDP per capita in nominal terms was USD 26,075 and growth forecasts for 2010 are in the 3.5 percent range. The

deficit in 2009 was 5.15 percent of GDP, lower than the 6 percent target set by the GoI primarily due to higher than expected tax revenues. Ministry of Finance officials believe that the external nature of the global crisis -- primarily hitting exporters of financial goods and markets such as derivatives -- limited damage to the local economy.

¶9. (SBU) In addition to a relative lack of sophistication in Israel's banking sector, the country's status as a high-tech goods exporter allowed for quicker rebounding than in the U.S. and Europe. Although total exports declined 13.2 percent for the year in 2009, imports declined more sharply, by 15.4 percent. However, industrial exports (excluding diamonds) as a percentage of exports of goods increased, accounting for 83 percent of the total according to data from the Central Bureau of Statistics. This appears to be due to a sharp increase in shipments of electronic components and computers, mostly accounted for by the opening of a new Intel production site in Kiryat Gat in early 2009. A return to export growth in Israel depends on the rate of global recovery, and the GoI recently announced an export guarantee plan to encourage exports and take on a measured part of the risk exports face.

¶10. (SBU) With a two-year budget in place, a measured and balanced monetary policy carried out by Bank of Israel Governor Stanley Fischer, and a fiscal program that has brought the debt-to-GDP ratio down to 78 percent from a height of close to 100 percent in 2003, Israel feels its admission to the OECD is all but guaranteed. The extended fiscal outlook for 2011 remains shaky, given planned tax cuts and the need to meet several budgetary obligations coming due. Nonetheless, the government is considering another two-year budget (2009-10 was its first) in hopes of retaining political stability and locking in multi-year budget commitments. Pending admission to the OECD has brought about many positive outcomes, including a push to reach an breakthrough IPR agreement and the impetus to address several socio-economic issues that endanger Israel's future economic success.

¶11. (SBU) Israel's economy, despite strong pre-crisis growth, is weaker than it appears. There are two economies: a progressive knowledge-based economy that engages 9 percent of the workforce, is globally quite competitive, and highly productive; and a far larger manufacturing and

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services economy which faces risks from globalization, with productivity stagnant. Israel's labor participation rate at 55% is among the lowest of developed countries, largely due to uniquely Israeli socio-religious factors. Engaging more people in productive employment will be key in coping with the growing number of retirees as the post-WWII baby generation leaves the workforce. However, engaging the underemployed groups -- chiefly Arab-Israelis and ultra-orthodox Jews -- poses a major challenge. Demographically these groups provide a growing percentage of the young Israeli population, and both groups lag in terms of education and civic engagement. The Ministry of Finance has announced its intention to ensure that expected growth reduces social gaps, in contrast to 2004-2008.

¶12. (SBU) Investing in its culture of innovation is also primary goal for the GoI, and creating linkages to under-represented groups within Israel, as well as regional linkages, provides one of the discussion points we hope you will explore with your interlocutors here. The combination of human capital and strong government support that has made Israel a world leader in renewable energy and information technology requires preservation. As the GoI investigates venture capital fund support in the field of life sciences, and the Tel Aviv Stock Exchange inaugurates a biomed index, it will be useful to encourage the GoI to extend the global reach of the solutions they implement. Global health, renewable energies, and food security are but some of the

issues that stand to benefit from the continued enhancement of Israel's high-tech prowess. Much as the IDF has recently exemplified the best of Israel's exercise of global citizenship in its mission to Haiti, the fruits of her innovation culture address global needs as well, improving agriculture through water technologies and bringing affordable renewable energy possibilities to underdeveloped markets.

¶13. (SBU) I believe your visit will advance discussions for partnership in many arenas, and I extend a warm welcome to you and your staff.

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